In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 243

ESTATE OF WALTER F. RAU, SR., DECEASED, RAYMOND J. SHORB, ADMINISTRATOR WITH THE WILL ANNEXED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (Pet. 12a–29a) are not officially reported. The opinion of the Court of Appeals (Pet. 1a–11a) is reported at 301 F. 2d 51.

JURISDICTION

The judgment of the Court of Appeals was entered on March 9, 1962 (R. 602). The taxpayer's petition for rehearing was denied on May 11, 1962 (R. 603). The petition for a writ of certiorari was filed on

July 12, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the Court of Appeals correctly decided that the 50 percent addition to tax imposed for fraud pursuant to Section 293(b) of the Internal Revenue Code of 1939 survives the death of the taxpayer.

2. Whether both courts below correctly decided that the Commissioner clearly and properly established the amounts of unreported income by evidence of specific omissions from income returned.

3. Whether both courts below correctly decided that the Commissioner fully sustained his burden of proving that a part of the deficiency for each of the taxable years was due to fraud with intent to evade tax.

STATUTES INVOLVED

Internal Revenue Code of 1939:

> SEC. 276. SAME—EXCEPTIONS.
>
> (a) *False return or no return.* In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.
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> * * * * *
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> (26 U.S.C. 1952 ed., Sec. 276.)
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> SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY—
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> * * * * *
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> (b) *Fraud.* If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid, in lieu of the

50 per centum addition to the tax provided in section 3612(d)(2).

(26 U.S.C. 1952 ed., Sec. 293.)

Internal Revenue Code of 1954:

SEC. 7454. BURDEN OF PROOF IN FRAUD AND TRANSFEREE CASES.

(a) *Fraud.*—In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Secretary or his delegate.

* * * * *

(26 U.S.C. 1958 ed., Sec. 7454.)

STATEMENT

The relevant facts, as found by the Tax Court (Pet. 12a–26a) and by the Court of Appeals (Pet. 1a–3a), may be summarized as follows:

During the years in question, 1942–1947, the decedent Walter F. Rau had earnings from, among other sources, two businesses—the French Cafe and a bar and liquor store known as the Southern Wine and Liquor in Bakersfield, California, where he also operated the Southern Hotel. (Pet. 1a–2a.)

The books of the French Cafe and Southern Bar were maintained by Rose Goldstein. In addition, she made out Rau's income tax returns for all the years except 1947. At all times material here, Robert R. Webb, manager of the Southern Hotel, had charge of the receipts of the French Cafe and Southern Bar and made daily bank deposits for both businesses. He also kept a daily record in a "year book" of the amounts deposited. (Pet. 2a–3a.)

The Commissioner determined that deficiencies were due because Rau's tax returns fraudulently understated his gross income from the cafe and bar, and

charged fictitious expenses and purchases against their purported earnings. (Pet. 2a.)

In making the adjustments and arriving at the decision to increase the assessment, the Commissioner principally relied upon information disclosed by Webb and Goldstein. At the hearing before the Tax Court they testified that Webb did not bank the entire receipts of the cafe and bar, but that, in compliance with Rau's instruction, he first removed from the daily receipts amounts varying from $10 to $200, depositing only the remainder. The withheld moneys were kept in the hotel safe, where they were allowed to accumulate until removed by Rau at the end of each month. These portions of the receipts of each business were not entered in the "year books" and were never reflected in Rau's income tax returns. (Pet. 2a, 3a–4a, 17a.)

The witnesses further testified that occasionally, after the deduction was made from the cafe receipts, not much remained. In such instances Rau directed Webb to make the deposit and purported receipts for the cafe "look respectable" by adding a check drawn on the cafe account in a sufficient amount to increase the deposit to more than $300. He further instructed Webb to enter these checks in the checkbook as payment for supplies, and the amount was treated as a business expense in his income tax returns. (Pet. 3a–4a.)

Webb and Goldstein further testifed that, upon instruction from the decedent, the cash journal of the cafe reflected cash purchases which had already been deducted from the receipts on the daily sheets, so that there resulted, in effect, a double deduction for such purchases. Over and above the overstatement of purchases shown in the cash journal, Rau instructed Goldstein in 1943 and 1944 to "raise the purchases" for the cafe on his income tax returns in order to reduce

his tax. This is corroborated by the cash journal and tax returns for those years. (Pet. 4a.)

At all times material herein, the decedent maintained a close inspection of the books and records of the French Cafe and Southern Bar, checked on the daily receipts and disbursements of these businesses, gave instructions as to daily and week-end withdrawals from those receipts, and, in general, made it a practice to know everything that was going on. During the years 1942 through 1946, and until he had a stroke in December, 1947, he was mentally alert and had a keen mind insofar as his businesses were concerned. (Pet. 24a.)

The Tax Court found that the Commissioner's proof overwhelmingly established fraud, that the testimony of Robert Webb and Rose Goldstein was strong and convincing and that it was in part corroborated by documentary evidence. (R. 26a–27a.) It further found that the evidence of specific items furnished a more accurate guide to the computation of decedent's net income than the net worth statement presented to the court (R. 28a), and that the Commissioner's adjustments (including those embodied in his amended answer), as to all items in controversy except certain minor receipts from the Southern Bar for the year 1942, were strongly supported by the evidence (R. 27a–29a.) The Tax Court accordingly determined the following deficiencies and additions to the tax for the taxable years involved (R. 88):

Year	Kind of tax	Deficiency	Additions to tax, Sec. 293(b) I.R.C. 1939
1942	Income	$5,901.47	$2,778.22
1943	Income and Victory	52,913.50	33,454.19
1944	Income	53,725.33	28,728.08
1945	Income	46,292.81	23,146.41
1946	Income	12,368.72	6,151.86
1947	Income	17,214.11	8,607.06

The Court of Appeals held that the Tax Court was correct in concluding that the decedent had filed false and fraudulent returns with an intent to evade tax in substantially the amounts determined by the Commissioner and that the 50 per cent addition to the tax imposed by Section 293(b) of the 1939 Code survives the death of the taxpayer. (Pet. 6a–11a.)

ARGUMENT

The courts below applied settled legal standards, no conflict of decisions is present, and there is no question which warrants further examination by this Court.

1. The petitioner seeks to show (Pet. 7–11) that Section 293(b) of the 1939 Code, *supra*, is a penal provision; that the assessment of the 50 per cent addition therein provided constitutes a fine intended as a punishment for an offender; and that, being penal in nature, such addition cannot survive the death of the wrongdoer. *Schreiber* v. *Sharpless*, 110 U.S. 76, 80. However, this Court has already ruled, in *Helvering* v. *Mitchell*, 303 U.S. 391, that Section 293(b) of the Revenue Act of 1928, which is the identical predecessor of Section 293(b) of the 1939 Code, was remedial rather than penal and acted "primarily" as a safeguard for the protection of the revenue and to reimburse the government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud. In addition, several Courts of Appeals have held that the addition to tax imposed by Section 293(b) survives the taxpayer's death and is not controlled by the concept of early law that an offender's death abates a cause of action for tort. *Kirk* v. *Commissioner*, 179 F. 2d 519 (C.A. 1); *Scadron's Estate* v. *Commissioner*, 212 F. 2d 188 (C.A. 2); *Lee* v. *Commissioner*, 227 F. 2d 181 (C.A. 5); *Reimer's Estate* v. *Commissioner*, 180 F. 2d 159 (C.A. 6), affirming *per curiam*, 12 T.C. 913, 920, 921.

Petitioner cites no case subsequent to *Helvering* v. *Mitchell, supra,* which sustains its position. It refers to the survival of the 50 per cent addition to tax as a "novel doctrine * * * of administrative origin" (Pet. 9), but fails to mention the decisions of the Courts of Appeal cited above. Moreover, the decision of this Court in *Simonson* v. *Granquist,* 369 U.S. 38, cited by petitioner (Pet. 9), does not support its contention. There it was held that Section 57(j) of the Bankruptcy Act specifically barred payment of penalties on a bankrupt's unpaid taxes. Here, of course, no such statute exists.

2. Although petitioner does not deny that there were deficiencies in the decedent's income taxes for the years involved, it contends that in determining such deficiencies the Commissioner should have relied on the increase-in-net-worth method rather than upon evidence of specific omissions from income. (Pet. 12.)

The Commissioner chose to establish the amount of decedent's unreported income by evidence of specific omissions from the income shown in the return. He relied upon the direct proof given by two persons who were in a position to know if any sums had been omitted, and who gave those sums with a high degree of precision. The tax court, which personally observed the witnesses, found (Pet. 28a) that on the present record the evidence as to specific items of understated income and overstated deductions furnished a more accurate and reasonable guide to the determination of decedent's net income than the net worth statement. The Court of Appeals found no error in the Tax Court's preference of one form of proof over another. (Pet. 6a.)

The issue here presented is primarily factual and has been resolved against the petitioner by the two courts below. These concurrent findings are not to

be disturbed except upon a clear showing of error. *Comstock* v. *Group of Investors,* 335 U.S. 211; *Corn Products Co.* v. *Commissioner,* 350 U.S. 46, 50. We submit that the decision below has ample support in the record and that there is no occasion for further review.

3. Petitioner contends that large understatements of income, without more, are insufficient to sustain the addition to tax for fraud and that here fraud was not established by clear and convincing evidence. (Pet. 12–13.)

Here, as shown by the schedule below, it is clear that a shocking disparity exists, not only between the net income reported by decedent in his tax returns and the amount determined by the Tax Court, but also between the amount reported on the returns and the net worth statement stipulated to by petitioner (R. 12–18, 81–87):

	Income reported	Net worth stipulation	Income determined under Rule 50 of the Tax Court
1942	$4,121.92	$14,557.64	$18,886.90
1943	17,859.24	46,232.20	104,904.18
1944	35,493.94	81,547.11	105,491.34
1945	44,959.78	102,854.84	100,649.89
1946	89,060.84	83,102.34	103,918.42
1947	27,371.48	30,681.27	53,940.57

A persistent failure to report large amounts of income over an extended period is, without more, strong evidence of fraudulent intent. *Holland* v. *United States,* 348 U.S. 121. Where, as here, the pattern of unrecorded and unreported income is accompanied by specific evidence of fraud, the requisite intent to evade tax is unmistakably clear.

In the instant case the evidence of fraud permeates the record. Decedent specifically instructed Webb and Rose Goldstein to withhold $10 and $25 per day from the receipts of the French Cafe and the South-

ern Bar, respectively. He instructed them to deduct additional amounts of $100, $150 and $200 from the businesses on week-ends and holidays. (R. 110, 117–121, 144–147, 362–363, 443–448, 482–485.) He instructed his bookkeeper to duplicate purchases and to set up false inventory records. (R. 435–436, 536–538.) During all the years involved here, decedent maintained a close inspection of the books and records of the French Cafe and the Southern Bar (R. 105–106, 503–504), hecked on the daily receipts and payouts (R. 105–106, 367–369, 376–377, 486–488), and closely supervised the affairs of these businesses. (R. 448–452, 463–464, 538.) During the period 1942 through 1946, and until he had a stroke in December 1947, he was mentally alert and, so far as business was concerned, had a keen mind. (R. 149–150, 463–465.)

Contrary to petitioner's assertion, it is obvious that the determination of fraud involved was supported by clear and convincing evidence.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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